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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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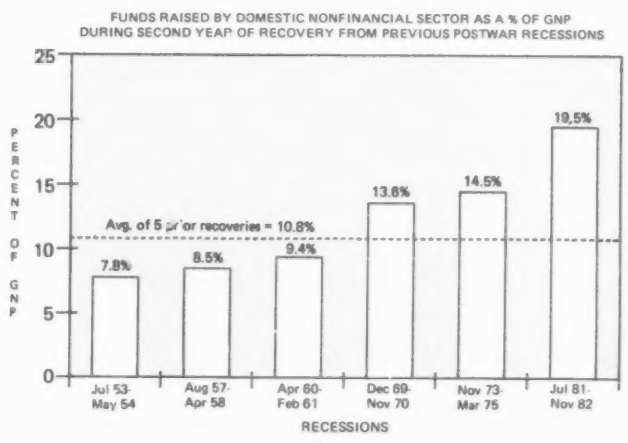
Swelling Credit Demands . . .

One of the more important determinants of the interest rate outlook this year will be the strength of economy-wide credit demands. At this stage of the business cycle, it is not unusual for credit needs to surge sharply higher, reflecting a widening gap between business spending and internal cash flow as well as stepped-up borrowings by households to finance everything from new homes to new furniture. This year, however, total credit needs are going to be pushed to abnormally lofty heights by Washington's apparently insatiable, and growing credit appetite. There are virtually no prospects that the current fiscal year red-ink total—which has been largely neglected in all the debates over cutting next year's Federal deficit—will be lower than the $175 billion deficit posted in fiscal 1984. What this does is set the stage for higher, rather than lower interest rates as 1985 unfolds—assuming, of course, that the Federal Reserve refuses to accommodate fully emerging household, business and Federal credit demands.

The shape of this year's credit market outlook was being set last quarter—and for those expecting further interest rate relief, the news was not good. According to the Federal Reserve, credit demands economy-wide soared after experiencing something of a growth pause in the third quarter. Borrowings by the domestic nonfinancial sectors—households, businesses and government—surged at an almost 14½ percent seasonally adjusted annual rate in the fourth quarter. Not surprisingly, with the Federal red-ink total hitting a quarterly record of $72 billion during the period, Washington's borrowings paced, but were not solely responsible for the upturn. Household and business borrowings also rose briskly, with quarter-over-quarter growth rates firmly riveted in double-digit territory. Against this backdrop, Federal Reserve Chairman Paul A. Volcker testified before Congress that the central bank's easing initiatives of last fall had come to an end (Financial Digest—February 25, 1985)—a one-two punch which set the stage for the reversal of the downward trend in interest rates.

. . . Could Set The Stage . . .

Nor is there much hope for any quick change in this situation. For one thing, the Federal deficit, and Washington's borrowing requirements, are seemingly locked into 12-digit territory. With interest and defense outlays rising rapidly, and attention not even focused on the current fiscal year, the persistence of double-digit rates of Federal debt growth are increasingly a good bet. For another, with today's business expansion remaining on track, household and business borrowings are unlikely to fade anytime soon.



Take, for example, the consumer. Household borrowings rose at an annual rate just a shade less than those of Washington in the fourth quarter, as consumers continued to acquire large amounts of both installment and mortgage debt. And not only was the pace of consumer borrowing not far from that of the Federal government, it was also close to that of the late 1970s—when a soaring rate of inflation was swelling credit needs in general, and consumers went on a buying and borrowing binge in order to protect themselves against the rapid escalation of prices. One result of recent developments is that the ratio of outstanding installment debt to disposable income is getting back to levels last seen in the late 1970s, possibly suggesting that the pace of consumer borrowings will soon have to slow if for no other reason than

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that the consumer is becoming overextended.

However, this may not be the case. For with both personal income tax rates lowered and inflation rates diminished, real household disposable income—what's left over after taxes and with the effects of inflation netted out—rose last year at its fastest rate since the early 1960s. This gave consumers not only the opportunity to use their fatter incomes to step up spending, but also to add to their financial assets. Over the past two years, in fact, household financial assets have soared by nearly $1 trillion (about a fifth of which was due to rising stock prices). With incomes and assets growing, even the nefty acquisition of mortgage and installment debt in recent months does not necessarily indicate a retrenchment by consumers is at hand. They now possess about $2.25 of financial assets for each $1 of debt outstanding, or 11 percent better than the early 1980 low point. Indeed, just lowering the assets-to-debt ratio back to where it stood in early 1980 would allow for almost 12½ months of borrowing at last year's breakneck pace—even if there was no additional financial asset accumulation!

. . . For Rising Interest Rates

So, too, a retrenchment in the pace of business borrowings is equally unlikely. With business spending for inventories, plant and equipment still running far ahead of cash flow and the pace of mergers and leveraged buyouts robust, business borrowings advanced at a hefty 12.3 percent annual

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 3/6/85	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	168.463	+ 2.502	+10.699
Loans to Depository Inst.	1.691	+ .337	+ 1.198
Float	.829	– .795	+ .370
Total Reserve Bank Credit	182.197	+ 1.879	+15.112
Treasury Deposits with Federal Reserve Banks	3.364	– .674	– .193
Currency in Circulation	178.553	+ .419	+10.975
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	115.296	– 1.119	– 2.674
	2/27/85		
Member Bank Reserves:			
Total Reserves Held	39.558	– .605	+ 3.589
Excess (Deficiency)	.751	– .256	+ .030
Net Free Reserves	.154	– .555	– .185
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (2/25/85)	572.7	‡	‡
M2 (January '85)	2,399.5	+ 13.9	+ 9.0
M3 (January '85)	3,022.4	+ 13.3	+ 11.1
Domestic Nonfinancial Debt (4th Q'84)	5,970.8	+ 14.4	+ 13.6

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Data unavailable due to revisions.

New York Money Market

Offering Rates 3/8/85	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	8.61%	8.87%	9.00%
* Federal Agencies	8.90	9.65	10.04
* Project Notes–Taxfree (46% Taxable Equivalent)	7.87	8.61	9.72
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	9.20	9.75	10.45

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	8.60%	Apr.	8.90%
15- 29 days	8.60	May	9.05
30- 59 days	8.80	Jun.	9.15
60- 89 days	8.90	Jul.	9.40
90-179 days	9.10	Aug.	9.45
180-239 days	9.40	Sep.	9.45
240-270 days	9.40		

‡ Industrial Paper–Prime			
30- 89 days	8.80%	†Federal Funds Effective Rate	8.45%
90-120 days	8.95		

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'84	$ 3,764	$ 3,695	$ 3,432
Gross National Product (1972 Dollars)*	4th Q'84	$ 1,665	$ 1,645	$ 1,573
Percent Change, Annual Rate	4th Q'84	4.9	1.6	5.9
Change in Consumer Prices*	Jan '85	2.4%	3.6%	7.2%
Change in Producer Prices*	Jan '85	0.0%	2.4%	8.4%
Civilian Employment (Thousands of Persons)†	Feb '85n	106,685	106,391	103,888
Unemployment as % of Civilian Labor Force†	Feb '85n	7.3%	7.4%	7.8%
Personal Income*	Jan '85	$ 3,130	$ 3,114	$ 2,897
Leading Indicators Composite Index (1967=100)†	Jan '85	166.7	163.9	164.5
Industrial Production Index (1967=100) †	Jan '85	166.6	165.9	158.5
Net Change in Consumer Installment Credit †	Dec '84	$ 6.95	$ 7.95	$ 5.78
U.S. Merchandise Trade Balance †	Jan '85	–$ 10.29	–$ 8.03	–$ 9.51
Plant and Equipment Expenditures*	1st Q'85	$337.85(a)	$321.40(a)	$293.15
Private Housing Starts (Thousands of Units)*	Jan '85	1,833	1,595	1,933
New Construction Expenditures*	Jan '85	$ 324.9	$ 318.4	$ 280.9
Total Business Inventories †	Dec '84	$ 566.5	$ 565.0	$ 514.3
Total Business Sales †	Dec '84	$ 416.9	$ 414.5	$ 395.7

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

rate in the fourth quarter, and at an even faster 13.3 percent rate during the year as a whole. While such borrowings did not place upward pressures on interest rates in recent months—dispersed as they were over a variety of debt instruments both here and, increasingly abroad—if they persist at such a lofty level for long and/or foreigners begin to lose some of their appetite for dollar-denominated corporate debt instruments, this situation could change, and quickly.

Which again raises the issue of the importance of foreign capital inflows to credit market stability—as many things do these days. For despite the fact that the level of funds raised in the credit markets last year by the domestic nonfinancial sector expressed as a percentage of gross national product reached a record high not only for this stage of the business cycle (see chart on page 1), but, also, for any year in the entire postwar period—and actually moved higher still in the fourth quarter—short- and long-term interest rates ended the year on a lower note than when it began. Two developments provide the explanation: First, a switch in the Fed's policy stance toward ease last fall and second, the rising level of net private capital inflows from abroad. These reached the equivalent of just about 13 percent of all funds raised in the credit markets by the nonfinancial sector in 1984—a record high proportion. The previous record: Set just one year earlier at eight percent.

Short Term Paper Outstanding
(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (2/20/85)	155,400	– 723	+13,407
New York City (2/27/85)	33,519	+ 152	+ 4,802
Commercial Paper (2/27/85)	247,202	– 847	+56,053

Bank Loans
(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Commercial and Industrial Loans			
Weekly Reporting Large Commercial Banks			
Nationwide (2/20/85)	252,965	+ 1,035	+ 27,058
New York City (2/27/85)	61,962	+ 419	+ 2,418
Total Loans and Leases Gross Adjusted			
Nationwide (2/20/85)	658,155	+ 2,876	+ 69,571
New York City (2/27/85)	141,924	+ 560	+ 9,067

Financial Markets

	Friday 3/8/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	8.86%	+ .01	– .84
180-Day Bills†	9.36	+ .02	– .74
Longest Bills†	9.71	– .04	– .69
Recent Issues:			
10s 2/28/87	10.55	– .15	
10⅝s 12/31/88	11.19	– .16	
11¼s 2/15/95	11.71	– .22	
11¼s 2/15/15	11.71	– .19	
Municipals:			
Bond Buyer–20 Bond Index* (3/7/85)	9.75%	+ .04	– .19
Blue List Total ($ Million)	$1,715	– $124	+ $ 379
30-Day Visible Supply ($ Million)	$3,443	+ $410	+ $ 786
Total	$5,158	+ $286	+ $1,165
Corporates:			
Moody's Aa Composite (3/7/85)	12.85%	+ .09	– .29
30-Day Visible Supply ($ Million)	$1,380	– $110	– $1,995
Stocks:			
Dow-Jones Averages:			
Industrials	1,269.66	– 29.70	+ 129.90
Transportation	615.37	– 19.33	+ 116.91
Utilities	147.77	– 1.03	+ 21.85
65 Stocks	515.97	– 12.14	+ 68.42
Standard and Poor's 500 Stocks	179.10	– 4.13	+ 24.75
N.Y.S.E. Composite Index	103.82	– 2.22	+ 14.88
N.Y.S.E. Avg. Daily Vol. for Week (000's)	108,942	– 1,644	+ 29,438

* 46% Taxable equivalent 16.06%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 3/8/85	Week Ago
Overnight	8.44%	8.63%
1 month	9.00	8.88
3 month	9.56	9.50
6 month	10.25	10.13
1 year	11.06	10.81
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	12.00%	11.75%
Long Term (7 to 15 yrs.)	12.30	11.90

FOREIGN EXCHANGE SPOT RATES New York Opening (3/8/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01453	68.8250
Canada	.7137	1.4012
Denmark	.08275	12.0850
France	.09557	10.4630
Germany	.2939	3.4025
Italy	.0004697	2129.00
Japan	.003822	261.67
Mexico	.004107	243.50
Netherlands	.2588	3.8640
Switzerland	.3427	2.9180
U.K.	1.0630	.9407

Thanks a billion.

Again!

In 1984, Manufacturers Hanover Leasing Corporation topped $1 billion in equipment financing, maintaining our industry leadership for the fifth consecutive year.

This achievement represents more than merely providing the funds to satisfy the increased need for capital expenditures. Rather, it is proof that we deliver the financial expertise, the creativity, and the experience demanded by our customers. Whether it be for special structuring. Or for a certain product—secured loan, vendor program, syndicated lease, international financing.

Our customers know that Manufacturers Hanover Leasing Corporation brings ingenuity and service to each transaction. That's why they come back to us. Again. And again.

In fact, repeat business represented a major share of the $1 billion we financed in 1984.

For the record, thanks to *all* our customers. For 1985 and beyond, we are committed to giving companies the kind of credit they deserve.

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